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by

Richard L. Meyer

Mayada M. Baydas

Geetha Nagarajan

and

Douglas H. Graham

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Rural Finance Program
Department of Agricultural Economics
The Ohio State University
2120 Fyffe Road
Columbus, OH 43212

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I. Introduction

Micro, small and medium enterprises (MSMEs) are increasingly recognized as being extremely important in most Sub-Saharan African (SSA) countries. Recent surveys have revealed their importance in both urban and rural areas (Meyer, et al., 1994). The MSMEs have been largely overlooked, however, in the design and implementation of most special credit programs until recent years. Most programs and policies designed to support economic activities in the post-colonial period in most SSA countries have been aimed at meeting the supposed financial needs of farms, larger industrial firms, and parastatal organizations. The economic difficulties faced in many countries have forced a fundamental rethinking of development strategies during the 1980s and 1990s, and this has promoted a closer look at smaller scale, more informal enterprises. Analysis has shown that they represent a surprisingly large share of total production, income generation, and employment creation.[1]

The question that has emerged from this analysis is how policies and programs should be redesigned to better serve MSMEs. An obvious conclusion is that the macroeconomic environment found in many countries must be revamped to stimulate private sector development, and the strong urban and large scale bias of many policies must be reversed. But when it comes to identifying how financial services should be improved at a time when targeted credit programs have been discredited and many financial institutions are just emerging from a decade of ill-advised lending, the recommendations are not so clear. Furthermore, there is a significant debate underway about how to develop sustainable financial institutions to serve the very poor.

The purpose of this paper is to summarize some in-depth research conducted on the financial system and small scale enterprises in The Gambia. Although the country is small, understanding its experience is useful because it is symptomatic of many larger SSA countries that are also reforming their formal financial systems. The paper is organized into three main sections. The next section summarizes key characteristics of the financial system, highlighting the formal banks, a special program for small scale enterprises, and the recent emergence of NGOs providing financial services. The section following then summarizes the findings of a survey of small peri-urban enterprises, and the last section presents a discussion of the major lessons learned in this research.

II. The Financial System of The Gambia

The financial system of The Gambia consists of formal banks, specialized credit institutions, such as cooperatives and credit unions, and, most recently, nonregulated NGOs that supply financial and nonfinancial services to the rural and urban participants in their programs. This section will summarize some of the key features of this system that are most relevant for MSMEs.

A. Formal Financial System[2]

For most of the past decade, The Gambia has been served by three or four banks. Most of their operations have been confined to urban and peri-urban areas. Over time, the total number of bank branches has ranged from 12 to 14 , and 9 to 11 of them have been located in greater Banjul. There has been considerable instability among newly created banks. Table 1 shows the year of opening and closing of banks during this decade. Two of the closings are associated with government supply-lending efforts to stimulate the economy through increased financial services. The first was the Gambia Commercial and Development Bank that just closed in 1992. From its origin, the bank dispensed targeted subsidized credit in a manner that compromised its sustainability. It always experienced difficulty in collecting loans, and in the end its accumulated arrears forced its closure and the acquisition of its performing assets by the Meridien Bank. Political interference encouraged the bank to lend to too many risky and/or welfare oriented projects. Donors also contributed to its demise by channeling subsidized loans through it for agricultural and small scale industry lending. For a time, it was an important lender for the parastatal Produce Marketing Board.

The second failed government institution was the Agricultural Development Bank which had an even shorter life of just seven years. Apparently it was also heavily affected by politics and the manager was reported to be one of the largest defaulting borrowers.

The country began an Economic Recovery Program (ERP) in 1985 with the assistance of the IMF and the World Bank. It was designed to eliminate some of the major macroeconomic distortions and subsidies that had been introduced into the economy over time. It also included liberalization of interest rates and the elimination of targeted and subsidized lending. Global credit lines were replaced by indirect monetary control through the use of reserve requirements and the issuance of government bonds and T-bills. The latter are sold to banks through bi-weekly auctions.

The impact of these changes is reflected in two ways. First, table 2 reports on credit allocation measured in real loans outstanding. The data reveal a steady decline in real loans outstanding to most subsectors. Agriculture is one of the subsectors most severely affected. Second, as the banks reduced their lending, they increased their nominal reserves and holdings of T-bills (table 3). The ratio of loans to deposits for all banks fell steadily from 1.43 in 1986 to 0.67 in 1991. These changes are explained in part by the banks' desire to seek safety and relatively high returns. In 1991, for example, the banks could obtain a real interest rate of 12-13 percent by investing in government paper. Even though average real lending rates were 18-19 percent at the time, this was not sufficient compensation for the banks to take the additional risk of lending.

Although there are no data to clearly show the extent to which MSMEs were affected by the changes in the banking system over the last decade, it seems logical to expect that most borrowers were large-scale and politically well-connected in order to get and refuse to repay subsidized loans. It is not likely that many small and medium sized enterprises would have been that successful in getting these formal bank loans.

B. Special Microenterprise Program [3]

The World Bank initiated an enterprise development project in 1988, but the funds were not utilized. Banks were to borrow from a fund deposited in the Central Bank at an interest rate of three percent below the T-bill rate and on-lend at the prevailing market interest rate (almost 27 percent in 1992). The interest charge to the banks would have been about 15 to 16 percent at a time when regular time deposits cost only 12 percent, so there was little incentive to use the higher cost WB funds.

This left the Indigenous Business Advisory Service (IBAS) as the only source of training and formal financial services for small scale firms. IBAS has operated since 1976 as a government program, currently under the Ministry of Trade, Industry and Employment. Its principal function is to stimulate employment creation through the development of small scale enterprises. Services are offered to enterprises that employ five or less employees. In 1992, 600 members were registered with IBAS. The majority were engaged in manufacturing, retail trade and horticultural marketing. Advisory and consulting services, training, and financial assistance are included in its programs. Loans are granted for periods ranging between two to three years and are generally scheduled for monthly payments.

IBAS currently administers three loan schemes. The first is funded by the European Economic Community (EEC) Fund, the second by the UN Capital Development Fund (UNCDF), and the third by the government as a Resettlement Program for Retrenched Civil Servants. A total of almost 5 million dalasis (close to US $500,000) have been lent to 433 borrowers since its inception (table 4). Services and manufacturing each represented over 40 percent of the loans made with agriculture representing 13 percent of the borrowers. The average loan size was just under 12,000 dalasis (about U.S. $1,300) for an average term of 27 months at an average interest rate of 9.7 percent. Although IBAS has a few up-country offices, about 80 percent of the loans were concentrated in the greater Banjul area.

No new loans have been made in any of the three credit lines since 1988. One of the explanations is the high arrears rates in all three programs and an overall arrears rate of 44 percent. Obviously IBAS is not a sustainable method for providing financial services. It has not been able to develop effective procedures for use in lending and in loan recovery. The low average interest rate relative to the fairly high inflation rates have made these loans attractive enough for borrowers to incur the high transaction costs of obtaining them. But the borrowers have not developed enough of a commitment to the program to repay them. Furthermore, an analysis of the delinquent portfolio showed that the arrears rate was positively correlated with loan size suggesting that borrowers of larger loans may have political support to avoid repayment.

One of the problems in the design of this approach to lending is that IBAS is not a financial institution so that the loans were actually handled by the now defunct Gambia Commercial and Development Bank. Loan recovery authority did not rest with IBAS. Reforms initiated in 1992 were designed to raise interest rates so a larger proportion of costs could be recovered, and to give IBAS responsibility for collections. If this reform is accomplished and the staff are given sufficient incentives and authority to operate a viable program, it may be possible to salvage it. At the time of this study, however, it was a small and expensive operation, serving few customers and saddled with a poorly performing portfolio.

C. NGO Financial Services

In the early 1990s, there were over 100 international and national NGOs reportedly working in The Gambia. Most concentrated in providing a variety of educational and other services to the rural and urban poor. As lending from the formal financial institutions declined, a number of the NGOs began offering financial services. NGOs represented almost 18 percent of total agricultural lending in 1991-92. No estimate is available for nonagricultural lending. Most of the NGOs with strong links to foreign sources of funds engaged in subsidized lending. The national NGOs often had to mobilize their own funds so they offered savings services and pursued higher interest rate policies for savings and lending. This difference in philosophy about interest rates led to great confusion among borrowers when two programs operated side-by-side with widely different terms and conditions.

NGO loans were granted to individuals and to groups (called kafos). Sometimes NGO funds were channelled through traditional kafos,[4] and sometimes the NGO organized kafos specifically for this purpose.

Although there was incomplete information, it appeared that the NGOs were operating small scale, highly subsidized lending operations. Frequently the loans made were targeted for specific production purposes associated with an economic activity the NGO was trying to promote. It appeared that most NGOs were not geared towards becoming self-sufficient financial institutions. Their competing models and the associated confusion that emerged, however, has led the Central Bank to develop draft regulations to supervise them.

III. Micro and Small Scale Enterprises in The Gambia

The previous section summarized the sources of financial services available to enterprises. This section reports on a survey conducted of small scale manufacturing firms located in the greater Banjul area including the capital city and the surrounding suburbs. It is the only area in the country where there is a fairly large concentration of manufacturing firms. Four subsectors were included: modern and traditional bakeries, metal workshops, tailoring and tie-dye producers. Approximately 40 enterprises were sampled for each subsector.

The interviews revealed that most of the operators interviewed also owned the enterprises which had been in operation for about 10 years on average. They had an average of five employees and had about US $15,000 in total physical assets. Just over 70 percent of the entrepreneurs were male with an average age of 38 years. Only 14 percent were high school graduates and about 60 percent were illiterate.

Table 5 presents the information obtained for the entrepreneurs interviewed about the financial activities of their enterprises. Surveys conducted elsewhere usually report that savings, family and friends are the major sources of start-up capital for enterprises. That conclusion emerged in this survey as well. Formal loans were important for only the modern bakeries. Likewise, only the modern bakeries reported a significant percentage having received a formal loan during the past five years. Almost all these bakeries reporting deposits in formal institutions while a higher proportion of the other groups of entrepreneurs reporting savings in informal groups or with moneykeepers. Retained earnings financed current operations for all firms and 50 to 85 percent borrowed informally.

The use of suppliers credits and customer credits or advances varied widely by subsector. Only the bakers reported a significant amount of suppliers credit which tended to be accompanied with the purchase of flour. The metal workshops, tailors and tie-dye producers, on the other hand, reported a much higher proportion of financing by customers. Since much of the production in these three subsectors is for custom designed products, the entrepreneurs utilize customer advances as a means to both finance their operations as well as ensuring that the ordered products will actually be purchased. The considerable competition amongst suppliers of flour also leads to the use of suppliers credit as a part of a marketing strategy to increase sales. There appears to be less competition in the supply of inputs used in the other subsectors so suppliers credit is not as well established.

The fact that few formal loans are reported by these entrepreneurs is consistent with the situation reported in the previous section about the limited supply of formal loans available in the country. Although the results reported in table 5 undoubtedly reflect the preferences of entrepreneurs regarding choice of finance, they also reflect the fact that most lenders have not been actively seeking ways to lend to small scale firms. The attractive and safe returns available from T-bills discourages banks from trying to lend to risky, small-scale producers even though the length of time they have been in business suggests they have reached a certain stability. A significant percent also have deposits in banks. If they maintain their banking relationships, perhaps some will be able to eventually convince skeptical bankers of their creditworthiness.

IV. Lessons Learned

The experience summarized here for The Gambia confirms the findings of research conducted elsewhere in developing countries and provides some additional insights into some of the problems to be faced in improving the supply of financial services for small scale enterprises. First, the Gambian experience demonstrates once again the perils of pursuing a subsidized supply-leading approach to financial development. The problems are extensively documented in several publications including Adams, Aryeetey et al., Deschamps et al., Lieberson et al., McKean, Meyer et. al, 1992; Thillairajah, Von Pischke, and Webster.

In his recent review, Besley found few cases in which market failures provide a justification to intervene into rural credit markets. The same case can probably be made for most urban credit markets as well. The experience of several financial institutions in such diverse locations as in Indonesia (Chaves and Gonzalez-Vega; Patten and Rosengard), in Bangladesh (Hossain), in Kenya (Mutwa), and in Bolivia (Glosser) shows that under certain circumstances it is possible to provide financial services to micro and small scale enterprises on a sustainable basis.

The second general observation is that the banking sector is undergoing reforms at a time when the Gambian government needs to finance its deficits. The issuing of T-bills fills its need for budget management but provides such an attractive alternative for bank investments that there is little interest in developing innovations needed to serve small scale borrowers. It is difficult to address this problem without first resolving the governments' fiscal imbalances.

Third, NGOs are motivated to offer financial services because they perceive that the shrinkage of formal finance affects the poor with which they are working. Yet few NGOs have yet made the long term commitment required to design and successfully operate a sustainable financial intermediary. Much more is known today about the requirements for creating viable intermediaries.[5] Many NGOs have yet to resolve if they are going to continue to subsidize a few fortunate borrowers or develop a sustainable intermediary to benefit large numbers of poor enterprises and households. Probably only a few of the current NGOs offering financial services will ever make that commitment.

Finally, enterprise surveys regularly report the important role of trade credit and other forms of informal finance for small scale enterprises.[6] For some countries, part of the explanation for the large amount of informal finance is repressed and underdeveloped financial markets. Informal finance can expect to fall in relative importance as the formal financial system improves. There are aspects of informal finance, however, that reflect true comparative advantage. Traders and input suppliers, for example, often have considerable information about their customers that is accumulated over time through repeated transactions. This information can be used by them to determine which customer should receive credit and how much. Furthermore, through interlinked contracts, informal lenders have an advantage in collecting loans that is not available to formal lenders. Susu collectors, such as exist in Ghana, also accumulate information about their customers which can be useful in loan decisions.

The large and important role of informal finance suggest two implications. First, any regulatory restrictions on traders on-lending borrowed funds to their customers must be carefully reviewed because of their possible negative effect on trade credit. Second, options may exist in some countries for formal lenders to specifically agree to on-lend borrowed funds to their customers. In some cases, it may be possible for traders to guarantee loans made by formal lenders to their customers who they identify as most creditworthy. This three party arrangement would tap the traders' knowledge about their customers but not directly involve them in making and recovering loans made to small scale enterprises

Table 1. **Bank Openings and Closings in The Gambia, 1980/88 to 1992/93.**

Banks	Year Opened	Year Closed
	(1)	(2)
Gambia Commercial and Development Bank (GCDB)	1972	1992
Standard Chartered Bank (SCB)	[a]	operating
International Bank of Commerce and Industry (BICI)	[b]	operating
General Merchant Financial Institution (GMFI)	1980/81	1981/82
Agricultural Development Bank (ADB)	1981/82	1988/89
International Bank of West Africa (IBWA-BIAO)	1982/83	1985/86
Continental Bank (CB)	1990/91	in litigation
Meridien Bank (MB)	1992/93	beginning operation

Source: Central Bank of The Gambia.
Note a: The Standard Chartered Bank dates back to the Colonial Period.
b: The BICI was founded shortly after Gambian independence in the mid-1960s.

Table 2. **Measures of Real Sectoral Commercial Bank Credit in The Gambia, 1981-1991 (Loans Outstanding, millions of 1976/77 dalasis).**

Year	Agr.	Fish.	Constr.	Trade	Tourism	Transp.	Other	Personal
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1981	44.15	2.13	9.05	28.97	10.71	4.35	25.51	16.86
1982	48.10	1.21	8.50	27.12	11.17	5.53	17.13	16.49
1983	49.15	2.02	6.53	24.24	13.04	5.67	24.38	18.52
1984	31.07	8.08	8.63	37.15	12.50	6.49	6.43	15.75
1985	29.89	8.00	11.55	28.36	11.81	4.18	12.92	17.15
1986	21.54	9.12	12.08	23.25	7.35	3.62	9.58	10.75
1987	13.59	4.79	7.32	16.30	4.84	4.16	8.26	9.11
1988	14.27	6.09	6.32	15.39	6.47	4.09	4.94	9.22
1989	9.03	5.84	5.74	13.61	8.67	2.51	11.23	9.64
1990	4.48	4.69	3.94	13.66	9.02	0.75	10.71	9.01
1991	4.89	4.56	2.84	16.86	8.39	0.59	9.01	9.38

Source: Central Bank of the Gambia, Various Bulletins.

Table 3. Liquidity Position of Commercial Banks in The Gambia 1987-1990, (millions of current dalasis).

		1987	1988	1989	1990	1991
		(1)	(2)	(3)	(4)	(5)
1. Liquid Assets	(2 + 5)	102.08	150.54	144.61	177.69	193.72
2. Reserves	(3 + 4)	54.63	60.91	41.80	50.75	72.26
3. Deposits at CBG		49.99	54.47	34.93	41.75	58.43
4. Cash Holdings		4.64	6.44	6.87	9.00	13.83
5. T-Bills		47.45	89.63	102.81	126.95	121.46
6. Required Liquid Assets		73.88	87.69	96.23	103.99	124.15
7. Required Cash Reserves		33.94	41.17	43.25	48.78	59.08
8. Excess Cash Reserves	(2 - 7)	20.69	19.74	-1.45	1.97	13.18
9. Excess Liquidity	(1 - 6)	28.20	62.85	43.38	73.70	69.57

Source: Central Bank of the Gambia, Annual Report, 1990/1991, Table VIII.

Table 4. Characteristics of the Indigenous Business Advisory Service (IBAS) Portfolio by Program Funding Source as of June 1991.

	Program			
Item	EEC	UNCDF	Government	Total
Year Started	1986	1985	1987	
No. of Borrowers	121	188	124	433
Disbursement[1]	1,017,297	2,797,204	1,140,788	4,955,290
Amount Due[1]	1,261,763	3,557,591	1,345,512	6,164,867
Av. Loan Size[1]	8,407	14,879	9,200	11,444
Av. Maturity (months)	23	27	33	27
Av. Interest Rate (%)	11.6	10.5	6.8	9.7
Arrears Rate (%)	27.3%	37%	77%	44%

Source: Information derived from IBAS records.
Note 1: All amounts are in Dalasis.

Table 5. Sources of Financing for Small Scale Enterprises.

Item	Bakeries: Modern	Bakeries: Traditional	Metal Workshops	Tailor Workshops	Tie-Dye Producers
	(Percent of Entrepreneurs Reporting)				
Initial Capital					
Savings	15	69.2	92.1	48	55
Family	7.7	11.5	7.9	34	27.5
Friends	0	0	0	5.6	2.5
Formal Loan	77	0	0	2.8	9.5
Supplier Loan	7.7	19.2	0	0	12.5
Funds for Current Operations					
Retained Earnings	100	100	100	100	100
Informal Loans	54	69	68	50	85
Formal Loans	59	0	10	39	22
Supplier Credit	85	81	0	22	27
Customer Credit/Advance	0	0	97	92	50
Formal Loans					
Received a Loan in the Past Five Years	62	0	0	29.6	17.5
Received a Loan in the Past Year	39	0	0	11.4	2.5
Ever Received a Loan	62	0	16	47	25
Savings Activities					
Deposits in Formal Institutions	90.9	0	16	47	25
Participating in Informal Groups	0	8	5	44	65
Saving with Moneykeepers	0	38.5	16	0	7.5

Source: OSU Enterprise Survey.

ENDNOTES

1. Several field surveys conducted by Michigan State University have documented the importance of small scale enterprises in several developing countries. In addition, recent studies by the GEMINI project of DAI and the World Bank report similar findings.

2. This section is drawn from Pollard et al.

3. This section is drawn from Baydas et al.

4. Nagarajan et al. (1994) report an analysis of the operations of kafos in villages and raise questions about the wisdom of NGOs utilizing kafos for on-lending because of possible negative spillover effects on other kafo functions.

5. See, for example, the publications by Christen, Rhyne and Vogel; Otero and Rhyne; and Rhyne and Rotblatt which discuss the characteristics and approaches of the most viable institutions.

6. See a recent example for Ghana in the paper by Aryeetey et al.

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